

Message Text

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ACTION NEA-10

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TAGYGC EGEN, NP, OVIP (ARYAL, KRISHNA RAJ)

SUBJ: FOREIGN MINISTER'S VISIT TO WASHINGTON:
CURRENT ECONOMIC SITUATION IN NEPAL

1. SUMMARY: DESPITE LITTLE PROSPECT OF NEAR-TERM CHANGES IN THE SNAIL-PACED GROWTH OF NEPAL'S ECONOMY, CERTAIN SYSTEMIC CHANGES ARE OCCURRING WHICH HAVE LONG-RANGE IMPLICATIONS FOR THE COUNTRY'S PROBLEMS AND PROSPECTS. THESE INCLUDE A GREATER GOVERNMENTAL EMPHASIS ON PRODUCTIVITY, A SHARP DETERIORATION IN THE BALANCES OF TRADE AND PAYMENTS, AND A NEW WILLINGNESS TO INCUR A HEAVY EXTERNAL DEBT BURDEN IN CONJUNCTION WITH A PRONOUNCED SHIFT FROM GRANT AID TO LOANS IN DEVELOPMENT FINANCING. ECONOMIC RELATIONS WITH INDIA CONTINUE TO BE CRUCIAL TO NEPAL, BUT MARKED WITH AN UNDERCURRENT OF MUTUAL SUSPICION. RENEWAL OF THE TRADE AND TRANSIT TREATY WITH INDIA, DUE NEXT YEAR, MAY -- OR MAY NOT -- BE THE OCCASION FOR A RESURGENCE OF FORMAL DISCUSSION OF PROBLEM AREAS. END SUMMARY.

2. ALTHOUGH THERE HAS BEEN LITTLE OVERT CHANGE AND TEMPO

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IN THE WORKINGS OF THE NEPALESE ECONOMY OVER THE PAST YEAR,

1975 MAY IN RETROSPECT PROVE TO HAVE BEEN A WATERSHED
RPBUR. A BURGEONING TRADE DEFICIT, GROWING RELIANCE ON
DEFICIT FINANCING, RAPID INCREASE IN EXTERNAL S BT, AND
CHANGING ORIENTATION OF DEVELOPMENT ACTIVITIES ALL HERALD A
TRANSITION TO A NEW PATTERN OF ECONOMIC PROBELMS AND
PROSPECTS. THERE ISO TILL NO EARLY PROSPECT OF A BREA WVA
THROUGH IN AGRICULTURE, ON WHICH SIGNIFICANT GENERAL IMPROVE-
MENT OF THE ECONOMY DEPENDS. HOWEVER, WITH AT LEAST A
MODICUM OF BASIC INFRASTRUCTURE NOW IN PLACE, HMG, WITH THE
COMMENCEMENT OF ITS FIFTH FIVE YEAR PLAN, IS PUTTING A NEW
T
EMPHASIS ON " THE PRODUCTIVE SECTORS," I.E., AS OPPOSED TO
INFRASTRUCTURAL AND SOCIAL PROGRAMS, IN BOTH ITS OWN
PROGRAMMING AND IN UTILIZATION OF FOREIGN AID. MOST
STRIKINGLY, 1975 MARKS A TURNING POINT. THE PATTERN OF
NEPAL'S BALANCE OF TRADE AND OF PAYMENTS. AFTER YEARS OF
STEADY ACCUMULATION, CONVERTIBLE FOREIGN EXCHANGE RESERVES
HAVE BEGUN A SHARP DECLINE, DROPPING FROM \$128 MILLION
(OFFICIAL PLUS COMMERCIAL BANK HOLDINGS) TO \$99 MILLIT IN
THE SIX MONTHS FROM NOVEMBER TO MAY. THIS IS A RESULT BOTH
OF A WIDENING OVERSEAS TRADE GAP AND OF THE NEW NECESSITY
OF PAYING IN CONVERTIBLE CURRENCES FOR PETROLEUM PRODUCTS
(AND CERTAIN OTHER ITEMS) OBTAINED THROUGH INDIA. A
CONCOMMITANT EFFECT ON THE OTHER HAND HAS BEENC RELATIVE
IMPROVEMENT IN THE HARD-PRESSED INDIAN RUPEE BALANCE,
WHICH HAD GONE AS LOW AS \$17 MILLION EQUIVALENT LAST YEAR,
BUT WAS UP TO \$25 MILLION WORTH BY MAY. AN INCREASING
RELIANCE ON LOANS AS OPPOSED TO GRAIN AID IS ANOTHER NEW
TREND. THE ROLE OF MULTILATERAL AID DONORS, NOTABLY ADB
AND IBRD, IS RAPIDLY GROWING, AND NEPAL GOT ITS FIRST TASTE
OF PETRODOLLARS THIS SUMMER WITH A KUWAITI LOAN COMMITMENT
OF \$17 MILLION FOR THE KHULEKANI HYDROELECTRIC PROJECT.
ALTHOUGH NOT KEEN ABOUT ASSUMING THESE NEW LEVELS OF
EXTERNAL DEBT, HMG SEEMS RESIGNED TO THE NECESSITY.

3. FOREIGN AID ASIDE, INDIA CONTINUES TO BE THE
DOMINATING EXTERNAL FACTOR IN NEPAL'S ECONOMY. WHILE NEPAL
HAS MADE MARGINAL PROGRESS IASDIVERSIFYING ITS IMPORT
SOURCES, IT IS STILL OVERWHELMINGLY DEPENDENT ON INDIA, BOTH
AS A TRADING PARTNER AND AS A SOURCE OF "INVISIBLE" EARNINGS,
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I.E., REMITTANCES OF NEPALESE EMPLOYED IN INDIA. THE
PERENNIALY TOUCHY ISSUE OF TRANSIT RIGHTS THRGUGH INDIA
WAS STIRRED UP A BIT IN JULY BY A RADICAL INCREASE IN
DEMURRAGE AND OTHER PORT CHARGES ON THE NEPALESE TRANSIT
FACILPUTUS AT CALCUTTA PORT. IN GENERAL, ALTHOUGH THERE
ARE NO OTHER CURRENT AREAS OF ACTIVE DISAGREEMENT, THE
NEPALESE CONTINUE TO BE NERVOUS ABOUT THEIR ECONOMIC
DEPENDENCE ON INDIA AND ABOUT INDIA'S PERCEIVED PROCLIVITY

TO TWITCH ITS GRASP ON THE TRANSIT JUGULAR TO KEEP NEPAL IN LINE. THE INDIANS FOR THEIR PART CONTINUE TO BE SKEPTICAL ABO THE WHOLEHEARTENDESS JF HMG'S DEDICATION TO SUPPRESSION OF SMUGGLING OF THIRD-COUNTRY GOODS INTO INDIA AND INTENT, AS A MATTER OF POLICY, ON REDUCING THE SPECIAL AND FAVORABLE TREATMENT ACCORDED BY INDIATTO THE NEPALESE ECONOMY. THE 1971 TRADE AND TRANSIT AGREEMENT IS DUE FOR RENEWAL NEXT YEAR. IT REMAINS TO BE SEEN WHETHER THE TREATY WILL BE ROUTHXLY REVIEWED AS SEEMS TO US LIKELY, OR WHETHER ISSUES SUCH AS ADEQUATE SUPPLY OF TRANSPORT, PRICING OF INDIAN EXPORTS TO NEPAL, CUSTOMS RED TAPE, PORT FACILITIES AND SMUGGLING WILL BECOME MAJOR BONES OF CONTENTION.

4. ANOTHER SENSITIVE ISSUE IS THE AVAILABILITY OF ESSENTIAL IMPORTS FROM INDIA. WHILE THE DELIVERY OF ADEQUATE AMOUNTS OF BASIC ITEMS SUCH AS COAL, STEEL AND CEMENT IS THEORETICALLY ASSURED UNDER THE "QUOTA GOODS" ARRANGEMENT, NEPAL PERCEIVES A DISTURBVING TREND TOWARD DELAYS IN DELIVERY TIMES, LINKED WITH THE OBSERVATION THAT PAYMENT IN HARD CURRENCY WOULD PRODUCE IMMEDIATE DELIVERY.

5. THE HYPER-INFLATION WHICH HAS BEEN PLAGUING THE NEPALESE ECONOMY IS BEGINNING TO ABATE SOMEWHAT IN RESPONSE BOTH TO HMG MONETARY ACTIONS AND TO STABILIZATION OF INDIAN PRICES. AS AN ADDED MEASURE, HMG EARLIER THIS MONTH PROMULGATED A "BLACKMARKETING AND OTHER SOCIAL CRIMES ACT" DESIGNED TO CRACK DOWN ON BLACKMARKETING, PRICE MANIPULATION, EXCESS PROFITS AND SMUGGLING. ULTIMATELY, HOWEVER, PRICE STABILITY (ASIDE FROM IMPORTED INFLATION) DEPENDS ON AGRICULTURAL PERFORMANCE, AND ON THE AVAILABILITY OF IMPORTED GOODS -- LIMITED OFFICIAL USE

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WHICH AGAIN GOES BACK TO THE KEY AREA OF TRADE AND TRANSIT RELATIONS WITH INDIA. CARGO

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